

Apologies for the delay this month in getting our note to you: Hunter was on vacation the first week of August. As you likely noticed already, July produced good returns for stocks. The S&P 500 rose 2.2 percent, the Dow Jones 0.2 percent, the Russell Mid-cap 1.9 percent and the Russell 2000 (small-caps) 1.7 percent. July performance reverted to 2024 and 2023 from a thematic perspective with large positive in AI-related stocks – the Russell 1000 Growth rose 3.8 percent while the Russell 1000 Value increased only 0.6 percent. Developed international stocks suffered small declines as a result of a strengthening dollar, with the MSCI EAFE falling 1.4 percent. Despite the dollar strength, the MSCI Emerging Markets Index rose 2.0 percent for the month because of a surge in Chinese markets. Bonds were slightly off for the month with the Bloomberg Aggregate bond index falling [0.3 percent](#).

The markets in June and July largely upended the 2025 trends through May – in which international rather dramatically outperformed domestic and market breadth was much greater than the last two years with value stocks outperforming growth. The table below compares performance of many of the indices we mention in these missives year-to-date through May 30th and YTD through August 11th, 2025.

Index	Return Through May 30 th	Return through August 11 th
S&P 500	1.1%	9.5%
Dow Jones Industrial	0.1%	4.8%
Russell 1000 Growth	-0.3%	11.4%
Russell 1000 Value	2.5%	6.7%
MSCI EAFE	21.2%	21.2%
MSCI Emerging Markets	8.9%	19.0%
Bloomberg Aggregate Bond	2.4%	4.4%

[Source - May 30th Data](#)

[Source - August 11th Data](#)

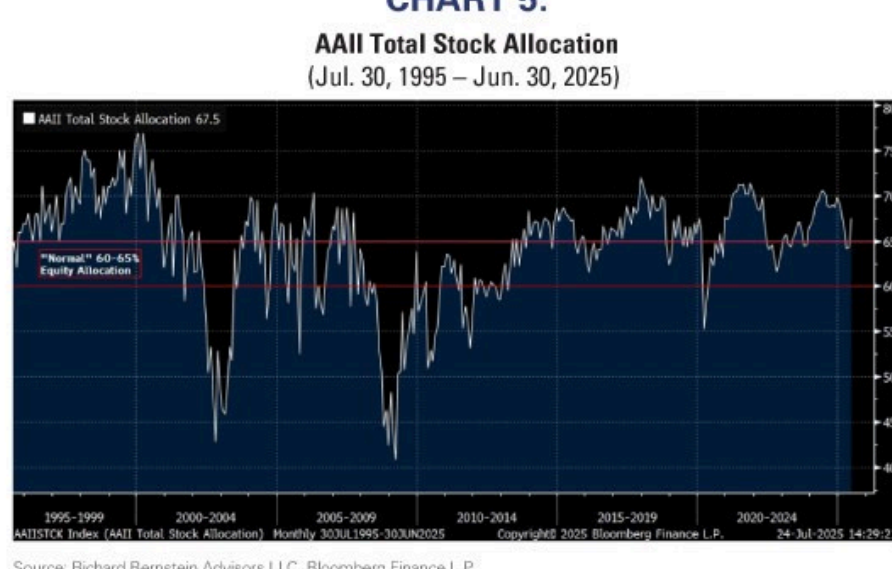
The obvious question that comes to mind after these last two months is: has the narrow Magnificent 7 and AI-driven bull market of 2023 and 2024 resumed in earnest? While we are still generally optimistic with regard to overall performance (the Fed seems almost certain to cut rates this year now), we won't be quick to pile on the reemergence of the Mag 7 trend. Richard Bernstein wrote a [great article](#) on the ten signs he see currently that point to extreme speculation or market bubble conditions. We will highlight just a few that make us particularly cautious.



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[Source](#)

First and foremost, Bank of America's data shows that in June the average retail investor's equity beta was about 1.5 for the top 10 holdings. That's on top of private clients holding more equity exposure overall than just about any other time in the last 25 years. In other words, retail clients hold more stocks and riskier stocks in their portfolios than at any time since the technology bubble of the late 90s. That is not a recipe to make a student of market history salivate with additional risk appetite. If anything, this single indicator is probably best one we know of for predicting future periods of sub-par returns in whatever securities make up those top holdings. Note that the best times to buy stocks in the last 25 years were in 2003 and 2009-10. Precisely the points at which retail investors had their lowest overall equity exposures.



Source: Richard Bernstein Advisors LLC, Bloomberg Finance L.P.

[Source](#)

Second, according to Bernstein, the use of "zero-day options is at all all-time highs and about 75% of levered ETFs market capitalization is held by individual investors."

Furthermore, "as of July 28th, 35% of average daily volume is now in stocks with prices less than \$5."

Why are these data points concerning – generally at the tail-end of bull markets, retail investors flock toward penny stocks and leveraged trading through the use of options or levered investment products. It's been a consistent theme over the course of our careers. We conceive of it this way: after a long period of winning on just about everything attempted due to directionally favorable markets and ample liquidity, risk appetite increases for the average investor in response to previous success. It's a feedback loop where prices going higher makes investors believe the investments are more attractive because their price is higher – literally the opposite of what makes sense. If you're a buyer, cheaper is better, not more expensive. It's not wrong to think about the use of options, levered ETF products, and penny stocks as methods investors use to try to leverage or squeeze more risk from each trade or each available dollar. This process accelerates over time as riskier and riskier behavior is financially rewarded. The downside risk however becomes extreme. The instant markets move against the individuals employing such strategies, their portfolios can be wiped out almost immediately. Downside market movements in such securities tend to be nearly instantaneous and nearly total. Often such events precipitate a broader market liquidity shock that spills over, albeit temporarily by comparison, to safer parts of the markets as demands for capital, margin calls, and complete portfolio liquidations ramp up to "stop the bleeding."

Ultimately, while we remain optimistic on 2025, we also think Morgan Stanley's recommended approach as articulated in this month's [On the Markets](#) makes a lot of sense right now: "on Aug. 1, across-the-board tariffs, which raised the effective rate to the 18%–20% range, were reinitiated just as weak July nonfarm payroll data was released. The combination suggested that the market would suddenly be dealing with the end of two pauses—one pertaining to the start of the post-tariff trade regime and one to the potential September start of a Fed easing campaign. While these events may ultimately prove inconsequential to the intermediate-term bullish narrative, we are at a seasonally weak juncture when investors often rethink their forecasts. With that in mind, we continue to stand on the side of prudence versus exuberance and are pursuing a maximally diversified portfolio."

We agree that prudence and risk-control will be key in this risk-on environment. Earnings growth, while good, is almost certainly decelerating. CEO optimism is declining in concert. Tariffs (which are simply taxes by another name) are no more friendly to equity earnings than they were in April. While we have predicted all year that prediction is the tariffs therefore must be absorbed by companies suffering shrinking margins, declining sales, or both. At this point the corporate tax cut in the Big Beautiful Bill is in our view fully priced, but the hit to earnings from tariffs remains somewhat uncertain as markets attempt to assess the degree to which tariffs will be absorbed by companies versus consumers. We don't mean to give the impression we are turning bearish – we still see a lot of opportunity in underpriced securities that offer meaningful earnings power per invested dollar. But on the other hand, we are losing some sleep at night in fear of another rapid pullback in the Mag 7 stocks or even a more general liquidity driven risk-off event amplified by a loss of risk-appetite among the ever-growing maximally risk-seeking retail crowd.

On the positive side, the Fed seems even more likely to cut rates this year than we had forecast last month as a consequence of weaker than expected jobs data (Morgan Stanley) and the broader markets have come around to our way of thinking with regard to rate cuts). Furthermore, inflation should be pretty tame when it's reported this week if the Cleveland Fed's Inflation Nowcast once again proves accurate. The last forecast at the end of July was for just 0.16 percent for the month (July inflation came in at 0.2 percent after this was written during the compliance review process). We do want to note that the Cleveland Fed is anticipating inflation may jump in August, all the way back to 0.30 percent, as the tariffs finally begin to be reflected in prices to a greater degree. But as we have articulated before, describing price increases from direct tax effects as "inflation" is a reach. In no other circumstance we can think of – a sales tax increase, a vat tax, an increase in the corporate tax rate – would the associated price jump be deemed inflation as opposed to taxation.

One last reminder: while we won't again belabor the reasons for it, we continue to favor the weak-dollar narrative (as does Morgan Stanley), despite the dollar's July gains. We also think that in anticipation of the first Fed rate cut, fixed income investments – particularly municipal bonds for taxable investors – offer attractive risk-adjusted returns in relation to stocks at current market multiples.

As always, if you have any questions or concerns, please don't hesitate to reach out to any member of the team.

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